This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS SECTION 01 OF 03 FRANKFURT 009271

SIPDIS

STATE FOR EUR PDAS RIES, EB, EUR/AGS, AND EUR/ERA
STATE PASS FEDERAL RESERVE BOARD
STATE PASS NSC
TREASURY FOR DAS SOBEL
TREASURY ALSO FOR ICN COX, STUART
PARIS ALSO FOR OECD
TREASURY FOR OCC RUTLEDGE, MCMAHON

E.O. 12958: N/A
TAGS: ECON EFIN EUN
SUBJECT: BaFin guidelines on cross-border provision of financial services

T-IA-F-03-0058

¶1. (SBU) Summary: In September 2003, the German Financial Supervisory Authority (BaFin) issued interpretive guidelines on how it will treat the cross-border provision of financial services into Germany. According to the recent guidelines, targeted offers of banking or other financial products to a German customer by a provider located abroad require a German banking license unless the provider has a "European passport". Exemptions may be granted for interbank business and institutional investors, if the entities in question are effectively supervised in their home country. There seems to be a considerable lack of clarity among market participants on what the guidelines really mean for their business. Nonetheless, the BaFin is in a dialogue with the Association of Foreign Banks and has expressed its willingness to take account of their concerns End summary.

BaFin's new guidelines

¶2. (SBU) In September 2003, the German Financial Supervisory Authority (BaFin) issued interpretive guidelines on how it will treat the cross-border provision of financial services into Germany. These guidelines basically explain how the BaFin intends to interpret the existing Banking Act, which has not been changed. However, they do change administrative practice as they are based on a new definition of cross-border transactions.

¶3. (SBU) In the past, the BaFin only required a German banking license if transactions were carried out or services were provided on German soil. According to the recent guidelines, targeted offers of banking or other financial products to a German customer by a provider located abroad that are made repeatedly and on a commercial basis require a license unless the provider has a "European passport". The BaFin will, however, only give licenses to banks with a legal presence in Germany in the form of a branch or a subsidiary. A representative office would not suffice. If a foreign company has a branch in Germany, all the company's transactions with German customers must be carried out through and booked at this branch.

¶4. (SBU) The BaFin release exclusively refers to "targeted" offers, e.g. actively soliciting business in Germany. Providers of cross-border products and services that German customers have requested on their own initiative are excluded from the licensing requirement. No license is required, for instance, for lending business with large corporate customers or institutional investors, loan syndicates or for maintaining an existing business relationship. The guidelines do not distinguish between activities targeted at retail customers and those targeted at corporate customers or institutional investors.

¶5. (SBU) Under certain conditions, foreign entities may be eligible for exemption from the licensing requirement. This would be the case if "the entity does not require supervision given the nature of the business it conducts". Such an exemption will only be considered for interbank business and institutional investors, if the BaFin can assume that the entities in question will not require additional supervision in the host country due to effective supervision in their home country in accordance with internationally recognized standards. Moreover, the competent supervisor(s) in the home country must cooperate with the BaFin, and the applicant is required to submit a certificate from the competent authority/authorities of the home country that confirms to the BaFin that

the foreign entity concerned was granted a license for the banking operations and/or financial services that it intends to provide on a cross-border basis in Germany,

the commencement of the intended cross-border services in Germany raises no supervisory concerns and,

if such concerns should arise in the future, these will be reported to the BaFin.

Practical implications

¶6. (SBU) The BaFin's new guidelines also give a number of examples of practices of third country financial service providers that would no longer be legal without a license of German supervisors. For instance, if a foreign entity targets the German market generally to offer loans or
or
underwriting services, a license is required. This is, however, not the case if the offer occurs in the context of maintaining existing customer relations or upon the customer's own initiative. U.S. banks trying to sell their products via the internet, if the site is specifically targeted at the German market (e.g. in German language or providing German contact details), direct mailings or faxes would have to do so through a German branch and not directly from the U.S. Similarly, it would be illegal to have financial consultants fly into Germany for a specific bank lending operation with a potential new customer. Representative offices would only be permitted to watch market developments, but not to market products and deal with customers. Moreover OTC business for Germans in the U.S. or the execution of German orders by brokerage firms in the U.S. would be illegal, unless initiated at the request of the German client. Even the foreign subsidiary of a German bank would no longer be allowed to make offers to clients in Germany.

The BaFin's motivation

¶7. (SBU) In its press release announcing the publication of the guidelines the BaFin states that its objective is to improve investor protection, in particular in the light of increasing cross-border business and the use of new media such as the internet. Moreover, it wants to submit third country providers of financial services to the same competitive conditions as entities from within the European Economic Area (EEA).

¶8. (SBU) The responsible official at the BaFin told us that the guidelines were driven by the concern to prevent fraud vis--vis German investors, citing as a typical example a Cayman Island firm providing banking services via the internet. He stated that the BaFin's intention was by no means to impede "honest" business activities.

¶9. (SBU) However, there is speculation whether the BaFin's motivation is exclusively investor protection or whether tax and reciprocity issues also play a role. The Association of Foreign Banks (VAB) claims that the BaFin has two reasons for this stricter interpretation: Its "official" argument is that it wants to protect German investors from dubious companies that offer their services in Germany but do neither have a license to do so nor a physical presence in Germany. A typical example would be letterbox companies located in Nauru. Another reason, which is not officially quoted, is that banks that make money in Germany should pay taxes in Germany. Moreover, the guidelines might also help to limit tax evasion of investors. According to the VAB, the main target of the guidelines is Switzerland, which is attracting a lot of investment from Germany, partly also with the clear objective to evade taxes.

¶10. (SBU) The former managing director of the VAB told us that a BaFin official had mentioned to him that reciprocity considerations also play a role. This particularly concerns the US, with the BaFin official claiming that German banks cannot provide their services in the US without being supervised there, either.

Matter of interpretation

¶11. (SBU) Currently there seems to be a considerable lack of clarity among the banks concerned on what the guidelines really mean for their business. Most US banks have subsidiaries in Germany anyway, whose transactions would largely not be concerned by the guidelines. However, the general guidelines do not answer all questions with regard to sophisticated business models. There are specific business policies which may fall under the new rules, e.g. if transactions of a German subsidiary of a US bank are booked in an unregulated US entity. The chairman of the VAB board, Peter Coym, deplored that the BaFin guidelines put business models into question that have been used in Germany for decades. He also criticized that the status of representative offices was not sufficiently clarified so that they continue to operate in a gray area that leaves wide scope for interpretation.

¶12. (SBU) When we spoke with the responsible official at the BaFin, he stressed that in case it should turn out that the guidelines jeopardize legal transactions, the BaFin would be willing to consider modifications and that the wording of the guidelines may be considered as preliminary. He pointed out that for cases that are not explicitly mentioned in the guidelines, when in doubt foreign entities should contact the BaFin and discuss the issue. The BaFin would then be willing to work out a solution. For instance, the BaFin official said that if the service is provided by an entity that does not have a banking license in the US but is indirectly supervised by the Fed or the SEC and US regulators commit to informing BaFin in of any problems with

that entity immediately, the cross-border transactions could qualify for an exemption. Moreover, the BaFin appears to be inclined to regard US supervision as "effective".

Outlook

¶13. (SBU) The BaFin, in discussions with the Ministry of Finance, has already made many accommodations to VAB suggestions. The VAB as well as individual banks will proceed to report to BaFin any difficulties that may occur with regard to the guidelines. Further clarification and also adjustments to the rules can thus be expected.

¶14. (U) This cable coordinated with Embassy Berlin.

¶15. (U) POC: Claudia Ohly, Economic Specialist, e-mail OhlyC@state.gov; tel. 49-(69)-7535-222367, fax 49-(69)-7535-
¶2238.

BODDE